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August 6, 2008

Commissioner D'Arcy Dixon Pignanelli
Utah State Tax Commission
1950 West 210 North
Salt Lake City, UT 84134

RE: Petition to Amend Tax Commission Rule R865-~~19S-6~~ 6F-28 A

Dear Tax Commissioners:

Pursuant to Utah Code Ann. 63G-3-601(2), and Utah Admin. R. R15-2-1, et seq., and R861-1A-2.G., and on behalf of Questar Exploration and Production Company, we hereby request the Tax Commission to amend Tax Commission Rule R865-6F-28 as shown on Exhibit A to clarify that enterprise zone franchise and income tax credits are available to qualifying business entities regardless of whether the qualifying entity is included on a Utah combined report with an entity engaged in retail trade or a public utilities business.

Utah Code section 63M-1-413 authorizes credits against corporate franchise and income tax for businesses that hire employees or invest in equipment in an enterprise zone. Subsection 63M-1-413(5) provides that "[t]he tax credits under Subsections (1)(a) through (g) may not be claimed by a business entity engaged in retail trade or by a public utilities business."

Some Tax Commission employees have taken the position that credits are not available to a business entity in an enterprise zone if the entity is included on a Utah combined report with a public utility. To clarify Utah law on this issue for the benefit of both the taxpayers and the Commission staff, we respectfully request that Rule R865-6F-28 be amended.

To that end, for the reasons set forth below, we believe that under the statutory language, and the policy behind enterprise zones, non-retail and non-utility entities that create economic activity in an enterprise zone should be entitled to a credit without regard to other entities included on a combined report.

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Statutory Language

The statutory language expressly provides that a business entity may claim an enterprise zone credit on a separate return basis, even if the entity is included on combined return with a retailer or utility. Enterprise zone credits "may be claimed by a business entity," and "may not be claimed by a business entity engaged in retail trade or by a public utilities business." Utah Code § 63M-1-413 (emphasis added).[1]

The Legislature did not make the credits available or unavailable to "unitary groups," or even to "taxpayers." The credits are available or unavailable to "business entities." A "business entity" is statutorily defined as "an entity . . . including a claimant, estate, or trust . . . under which business is conducted or transacted." Id. § 63M-1-402(1) (emphasis added). A "claimant" is a "resident or nonresident person that has . . . Utah taxable income as defined in Section 59-7-101." Id. § 63M-1-402(1) (emphasis added). Utah taxable income means "federal taxable income as determined on a separate return basis before intercompany eliminations as determined by the Internal Revenue Code," plus Utah specific adjustments. Id. § 59-7-101(1), (3), (4), (27), (31), (32) (emphasis added).

Under the Internal Revenue Code, "federal taxable income determined on a separate return basis before intercompany eliminations" means the income of a "separate corporation[]" (Treas. Reg. 1-502.12) (emphasis added) prior to the consolidation of such income with income of other corporations, and the elimination of intercompany transactions on a federal consolidated return. See IRC 1501, 1502, 1552, and Treas. Regs. 1.502-12 and 1.502-13.

By allowing and disallowing the enterprise zone credit to a business entity (as opposed to a unitary group filing a combined return), and by ultimately

[1] All relevant language of the quoted statutes and regulations regarding qualification for an enterprise zone credit is included in Exhibit B.

defining "business entity" as a separate corporation viewed from a separate return basis, the statutes expressly provide that enterprise zone credits are allowed to a separately incorporated entity, even if that business entity is included on a combined return with a retailer or a utility.

The language of the draft rule in Exhibit A reflects this statutory language in allowing the credit for any separately incorporated business entity that is not engaged in retail trade or a public utilities business.

Policy

The express statutory policy behind enterprise zone credits also suggests that the credits should be applied to qualifying business entities, regardless of whether they are included on a combined return with a retailer or utility.

By statute, enterprise zone credits are designed to create economic activity in areas where there is "pervasiveness of poverty, unemployment, and general distress," or "chronic abandonment, deterioration, or reduction in value of commercial, industrial, or residential structures," and where "projected development in the zone will provide employment to residents of the county and particularly individuals who are unemployed or who are economically disadvantaged." Utah Code § 63M-1-406.

The prohibition on credits for retailers and utilities was passed in 1996. The utility prohibition was presumably added because utilities do not have a choice whether or not to locate in a particular area. The utility is already required by law to provide service in the enterprise zone. The retailer prohibition was presumably based on a legislative policy decision that stores selling groceries, clothing, etc. do not spawn the economic activity necessary to relieve distress in enterprise zones.

Based on the policy behind enterprise zones and the policy behind the retailer and utility statute, non-retail and non-utility business entities on a combined return with a utility or retailer should receive the credit.

To deny the credit to these entities defeats the purpose of the credit. These entities have a choice where they will locate, and when these entities establish their business in an enterprise zone, they hire employees, subcontractors and repairmen, invest in equipment, pay taxes, and spawn significant economic activity in that enterprise zone, just as the Legislature intended when passing the credit. These businesses should thus be entitled to the credit.

As an example, Questar Gas Company operates as a utility, but provides only 34% of the total Questar revenues. The other 66% of the revenues come from business entities like Questar Exploration & Production Company, an oil and gas exploration and production (E&P) company that is neither a utility nor a retail business. The E&P entities have a clear choice where to invest in facilities, hire employees, and drill for oil and gas. These E&P entities are a staple of the economy in the Uintah Basin, and are creating the very type of economic activity contemplated by the Legislature.

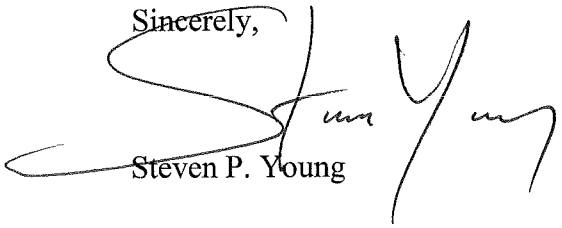
Denying the credit to these business entities is also discriminatory. It is inequitable to allow the credit to one entity operating in an enterprise zone, and to deny the credit to a competing entity next door that happens to be included on a combined return with a utility or retailer. Both businesses are hiring from the same pool of employees, paying the same property, sales, and income taxes, and creating economic activity within the enterprise zone. If a business entity qualifies for a credit, and is not involved in retail trade or a public utilities business, it should be entitled to the same tax credit as the business next door.

Denying the credit is presumably based on a concern by the Commission staff that utilities and retailers may receive a benefit of the credit on the combined return. This concern incorrectly views the credit through a paradigm of taxpayer benefit rather than rural development. If "taxpayer benefit" was the appropriate test, no entity should receive the credit if the entity is included on a combined report with an entity located outside the enterprise zone. In such a case, the benefits of the credit are flowing outside the enterprise zone (and often outside Utah). Tax Commission Rule R865-6F-28(1)(f) makes it clear that entities on a combined return can receive the investment tax credit (so long as the investment by the entity is "not in depreciable property of another

member of the unitary group.") Id. This is as it should be. The Legislature did not care where investment money came from, or where the benefit of the credit was received. The Legislature passed the statute simply to encourage rural investment by those with a choice, wherever and whomever they may be. So long as the entity creating the economic activity within the enterprise zone is not a utility or a retailer, the credit should be available, regardless of what utilities, retailers, or out-of-zone entities are included on a combined report.

We appreciate your attention to this issue, and respectfully request that the Commission amend Rule R865-6F-28 as shown.

Sincerely,



Steven P. Young

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Exhibit A

R865. Tax Commission, Auditing.
R865-6F. Franchise Tax.
R865-6F-28. Enterprise Zone Corporate Franchise Tax Credits Pursuant to Utah Code Ann. Sections 63-38f-401 through 63-38f-414.

(1) Definitions:

(a) "Based" means exclusively stored or maintained at a facility owned by the taxpayer:

(i) that is designed, constructed, and used to store or maintain equipment:

(A) that is transported outside of the enterprise zone; and

(B) for which the credit is taken;

(ii) where the equipment is located when it is not being used at facilities outside the enterprise zone, as evidenced by invoices, equipment logs, photographs, or similar documentation; and

(iii) from where the use of the equipment is directed or managed.

(b) "Business engaged in retail trade" means a business that makes a retail sale as defined in Section 59-12-102.

(c) "Construction work" does not include facility maintenance or repair work.

(d) "Employee" means a person who qualifies as an employee under Internal Revenue Service Regulation 26 CFR 31.3401(c)(1).

(e) "Public utilities business" means a public utility under Section 54-2-1.

(f) "Qualifying investment" does not include an investment made by a member of a unitary group in plant, equipment, or other depreciable property of another member of that unitary group.

(g) "Taxpayer" means the person claiming the tax credits in section 63-38f-413.

(h) "Transfer" pursuant to Section 63-38f-411, means the relocation of assets and operations of a business, including personnel, plant, property, and equipment.

(i) "Unitary group" is as defined in Section 59-7-101.

(2) For purposes of the investment tax credit, an investment is a qualifying investment if the plant, equipment, or other depreciable property for which the credit is taken is:

(a) (i) located within the boundaries of the enterprise zone; and

(ii) used exclusively in business operations conducted within the enterprise zone; or

(b) in the case of equipment or other depreciable property, based in the enterprise zone.

(3) The following examples relate to the investment tax credit.

(a) A furniture manufacturer operates a manufacturing facility that is located in an enterprise zone. The manufacturer purchases two trucks that are used exclusively at the facility and used to pick up raw materials from suppliers, some or all of whom may be outside the enterprise zone, and to deliver finished product to final customers, some or all of whom may be outside the enterprise zone. The trucks qualify for the investment tax credit because they are used exclusively in a business operation, the furniture manufacturing facility, that is located within the enterprise zone, even if they are stored or maintained at a facility located outside of the enterprise zone.

(b) If the same manufacturer described in Subsection (4)(a) had two facilities, one located within the enterprise zone, and one located outside the enterprise zone, and used the same two trucks for the same purposes for both facilities. The trucks are not based at a facility in the enterprise zone. The trucks would not qualify for the investment tax credit because they are not used exclusively at the facility located within the enterprise zone, and are not based in the enterprise zone.

(c) A business consists of a mine office located in an enterprise zone and a mine located outside the enterprise zone. Mining equipment is used exclusively at the mine and is not based in the enterprise zone. The business may claim the investment tax credit for plant, equipment, or other depreciable property located in the mine office, but not for plant, equipment, or other depreciable property used in the mine outside the enterprise zone.

(d) A business purchases equipment such as an oil rig, which is transported outside the enterprise zone to service facilities such as oil fields. If the use of the equipment is directed or managed from the enterprise zone and the equipment returns to a facility, within the enterprise zone, that is owned by the business for regular maintenance or storage, the equipment is based in the enterprise zone and therefore qualifies for the investment tax credit.

(e) The same business described in Subsection (4)(d) purchases equipment that is primarily stored or maintained at facilities that are located outside of the enterprise zone, but which may be occasionally stored or maintained in the enterprise zone. This equipment would not be based in the enterprise zone, and would not qualify for the investment tax credit, even if the business has other facilities in the enterprise zone.

(4) The calculation of the number of full-time positions for purposes of the credits allowed under Subsections 63-38f-413(1)(a) through (d) shall be based on the average number of employees reported to the Department of Workforce Services for the four quarters prior to the area's designation as an enterprise zone.

(5) To determine whether at least 51 percent of the business firm's employees reside in the county in which the enterprise zone is located, the business firm shall consider every employee reported to the Department of Workforce Services for the tax year for which an enterprise zone credit is sought.

(6) A business firm that conducts non-retail operations and is engaged in retail trade qualifies for the credits under Section 63-38f-413 if the retail trade operations constitute a de minimis portion of the business firm's total operations.

(7) If a business entity qualifies for a credit, and is included on a combined report with a business entity engaged in retail trade or a public utilities business, the combined group may claim a credit if the qualifying business entity is:

(a) not engaged in retail trade or a public utilities business,

(b) a separate legal entity from the business entity engaged in retail trade or the public utilities business, and

(c) operated at a separate physical location from the business entity engaged in retail trade or the public utilities business.

(~~7~~8) An employee whose duties include both non-construction work and construction work does not perform a construction job if the construction work performed by the employee constitutes a de minimis portion of the employee's total duties.

(~~8~~9) Corporate franchise tax credits may not be used to offset or reduce the $100 minimum tax per corporation.

(~~9~~10) Records and supporting documentation shall be maintained for three years after the date any returns are filed to support the credits taken. For example: If credits are originally taken in 1988 and unused portions are carried forward to 1992, records to support the original credits taken in 1988 must be maintained for three years after the date the 1992 return is filed.

(~~10~~11) If an enterprise zone designation is revoked prior to the expiration of the period for which it was designated, only tax credits earned prior to the loss of that designation will be allowed.

Exhibit B

Full Relevant text of Statutes and Rules Relating to Qualification for the Utah Enterprise Zone Credit

Utah Code § 63M-1-413. State tax credits

(1) Subject to the limitations of Subsections (2) through (4), the following nonrefundable tax credits against a tax under Title 59, Chapter 7, Corporate Franchise and Income Taxes, or Title 59, Chapter 10, Individual Income Tax Act, are applicable in an enterprise zone:

(a) a tax credit of $ 750 may be claimed by a business entity for each new full-time position filled for not less than six months during a given tax year;

(b) an additional $ 500 tax credit may be claimed if the new position pays at least 125% of:

(i) the county average monthly nonagricultural payroll wage for the respective industry as determined by the Department of Workforce Services; or

(ii) if the county average monthly nonagricultural payroll wage is not available for the respective industry, the total average monthly nonagricultural payroll wage in the respective county where the enterprise zone is located;

(c) an additional tax credit of $ 750 may be claimed if the new position is in a business entity that adds value to agricultural commodities through manufacturing or processing;

(d) an additional tax credit of $ 200 may be claimed for two consecutive years for each new employee who is insured under an employer-sponsored health insurance program if the employer pays at least 50% of the premium cost for two consecutive years;

(e) a tax credit of 50% of the value of a cash contribution to a private nonprofit corporation, except that the credit claimed may not exceed $ 100,000:

(i) that is exempt from federal income taxation under Section 501(c)(3), Internal Revenue Code;

(ii) whose primary purpose is community and economic development; and

(iii) that has been accredited by the board of directors of the Utah Rural Development Council;

(f) a tax credit of 25% of the first $ 200,000 spent on rehabilitating a building in the enterprise zone that has been vacant for two years or more; and

(g) an annual investment tax credit of 10% of the first $ 250,000 in investment, and 5% of the next $ 1,000,000 qualifying investment in plant, equipment, or other depreciable property.

(2) (a) Subject to the limitations of Subsection (2)(b), a business entity claiming a tax credit under Subsections (1)(a) through (d) may claim the tax credit for 30 full-time employee positions or less in each of its taxable years.

(b) A business entity that received a tax credit for its full-time employee positions under Subsections (1)(a) through (d) may claim an additional tax credit for a full-time employee position under Subsections (1)(a) through (d) if:

(i) the business entity creates a new full-time employee position;

(ii) the total number of full-time employee positions at the business entity is greater than the number of full-time employee positions previously claimed by the business entity under Subsections (1)(a) through (d); and

(iii) the total number of tax credits the business entity has claimed for its current taxable year, including the new full-time employee position for which the claimant, estate, or trust that is a business entity is claiming a tax credit, is less than or equal to 30.

(c) A business entity existing in an enterprise zone on the date of its designation shall calculate the number of full-time positions based on the average number of employees reported to the Department of Workforce Services.

(d) Construction jobs are not eligible for the tax credits under Subsections (1)(a) through (d).

(3) If the amount of a tax credit under this section exceeds a business entity's tax liability under this chapter for a taxable year, the amount of the tax credit exceeding the liability may be carried forward for a period that does not exceed the next three taxable years.

(4) (a) If a business entity is located in a county that met the requirements of Subsections 63M-1-404(1)(b) and (c) but did not qualify as an enterprise zone prior to January 1, 1998, because the county was located in a metropolitan statistical area in more than one state, the business entity:

(i) shall qualify for tax credits for a taxable year beginning on or after January 1, 1997, but beginning before December 31, 1997;

(ii) may claim a tax credit as described in Subsection (4)(a) in a taxable year beginning on or after January 1, 1997, but beginning before December 31, 1997; and

(iii) may qualify for tax credits for any taxable year beginning on or after January 1, 1998, if the county is designated as an enterprise zone in accordance with this part.

(b) If a business entity claims a tax credit under Subsection (4)(a)(ii), the business entity:

(i) may claim the tax credit by filing for the taxable year beginning on or after January 1, 1997, but beginning before December 31, 1997:

(A) a return under Title 59, Chapter 7, Corporate Franchise and Income Taxes;

(B) an amended return under Title 59, Chapter 7, Corporate Franchise and Income Taxes;

(C) a return under Title 59, Chapter 10, Individual Income Tax Act; or

(D) an amended return under Title 59, Chapter 10, Individual Income Tax Act; and

(ii) may carry forward the tax credit to a taxable year beginning on or after January 1, 1998, in accordance with Subsection (3).

(5) The tax credits under Subsections (1)(a) through (g) may not be claimed by a business entity engaged in retail trade or by a public utilities business.

(6) A business entity may not claim or carry forward a tax credit available under this part for a taxable year during which the business entity has claimed the targeted business income tax credit available under Section 63M-1-504.

Utah Code § 63M-1-402. Definitions

As used in this part:

(1) "Business entity" means an entity:

(a) including a claimant, estate, or trust; and

(b) under which business is conducted or transacted.

(2) (a) "Claimant" means a resident or nonresident person that has:

(i) Utah taxable income as defined in Section 59-7-101; or

(ii) state taxable income under Title 59, Chapter 10, Part 1, Determination and Reporting of Tax Liability or Information.

(b) "Claimant" does not include an estate or trust.

* * *

Utah Code § 59-7-101. Definitions

As used in this chapter:

(1) "Adjusted income" means unadjusted income as modified by Sections 59-7-105 and 59-7-106.

* * *

(3) "Apportionable income" means adjusted income less nonbusiness income net of related expenses, to the extent included in adjusted income.

(4) "Apportioned income" means apportionable income multiplied by the apportionment fraction as determined in Section 59-7-311.

* * *

(31) "Unadjusted income" means federal taxable income as determined on a separate return basis before intercompany eliminations as determined by the Internal Revenue Code, before the net operating loss deduction and special deductions for dividends received.

* * *

(36) (a) "Utah taxable income" means Utah taxable income before net loss deduction less Utah net loss deduction.

(b) "Utah taxable income" includes income from tangible or intangible property located or having situs in this state, regardless of whether carried on in intrastate, interstate, or foreign commerce.

(37) "Utah taxable income before net loss deduction" means apportioned income plus nonbusiness income allocable to Utah net of related expenses.

* * *

IRS Treas. Reg. § 1.1502-12 Separate taxable income.

The separate taxable income of a member (including a case in which deductions exceed gross income) is computed in accordance with the provisions of the Code covering the determination of taxable income of separate corporations, subject to the following modifications:

(a) Transactions between members and transactions with respect to stock, bonds, or other obligations of members shall be reflected according to the provisions of § 1.1502-13;

(b) Any deduction which is disallowed under §§ 1.1502-15A or 1.1502-15 shall be taken into account as provided in those sections;

(c) The limitation on deductions provided in section 615(c) [26 USCS § 615 (c)] or section 617(h) [26 USCS § 617(h)] shall be taken into account as provided in § 1.1502-16;

(d) The method of accounting under which such computation is made and the adjustments to be made because of any change in method of accounting shall be determined under § 1.1502-17;

(e) Inventory adjustments shall be made as provided in § 1.1502-18;

(f) Any amount included in income under § 1.1502-19 shall be taken into account;

(g) In the computation of the deduction under section 167 [26 USCS § 167], property shall not lose its character as new property as a result of a transfer from one member to another member during a consolidated return year if:

(1) The transfer occurs on or before January 4, 1973, or

(2) The transfer occurs after January 4, 1973, and the transfer is an intercompany transaction as defined in § 1.1502-13 or the basis of the property in the hands of the transferee is determined (in whole or in part) by reference to its basis in the hands of the transferor;

(h) No net operating loss deduction shall be taken into account;

(i) [Reserved]

(j) No capital gains or losses shall be taken into account;

(k) No gains and losses subject to section 1231 [26 USCS § 1231] shall be taken into account;

(l) No deduction under section 170 [26 USCS § 170] with respect to charitable contributions shall be taken into account;

(m) No deduction under section 922 [26 USCS § 922] (relating to the deduction for Western Hemisphere trade corporations) shall be taken into account;

(n) No deductions under section 243(a)(1), 244(a), 245, or 247 [26 USCS § 243 (a)(1), 244(a), 245, or 247] (relating to deductions with respect to dividends received and dividends paid) shall be taken into account;

(o) Basis shall be determined under §§ 1.1502-31 and 1.1502-32, and earnings and profits shall be determined under § 1.1502-33; and

(p) The limitation on deductions provided in section 613A [26 USCS § 613A] shall be taken into account for each member's oil and gas properties as provided in § 1.1502-44.

(q) A thrift institution's deduction under section 593(b)(2) [26 USCS § 593(b)(2)] (relating to the addition to the reserve for bad debts of a thrift institution under the percentage of taxable income method) shall be determined under § 1.1502-42.

(r) See §§ 1.337(d)-2 and 1.1502-35(f) for rules relating to basis adjustments and allowance of stock loss on dispositions of stock of a subsidiary member.

Internal Revenue Code § 1501. Privilege to file consolidated returns.

An affiliated group of corporations shall, subject to the provisions of this chapter [IRC Sections 1501 et seq.], have the privilege of making a consolidated return with respect to the income tax imposed by chapter 1 [IRC Sections 1 et seq.] for the taxable year in lieu of separate returns. The making of a consolidated return shall be upon the condition that all corporations which at any time during the taxable year have been members of the affiliated group consent to all the consolidated return regulations prescribed under section 1502 [IRC Sec. 1502] prior to the last day prescribed by law for the filing of such return. The making of a consolidated return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year, the consolidated return shall include the income of such corporation for such part of the year as it is a member of the affiliated group.

Internal Revenue Code § 1502. Regulations.

The Secretary shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the income-tax liability and the various factors necessary for the determination of such liability, and in order to prevent avoidance of such tax liability. In carrying out the preceding sentence, the Secretary may prescribe rules that are different from the provisions of chapter 1 [IRC Sections 1 et seq.] that would apply if such corporations filed separate returns.

Internal Revenue Code § 1552. Earnings and profits.

(a) General rule. Pursuant to regulations prescribed by the Secretary the earnings and profits of each member of an affiliated group required to be included in a consolidated return for such group filed for a taxable year shall be determined by allocating the tax liability of the group for such year among the members of the group in accord with whichever of the following methods the group shall elect in its first consolidated return filed for such a taxable year:

(1) The tax liability shall be apportioned among the members of the group in accordance with the ratio which that portion of the consolidated taxable income attributable to each member of the group having taxable income bears to the consolidated taxable income.

(2) The tax liability of the group shall be allocated to the several members of the group on the basis of the percentage of the total tax which the tax of such member if computed on a separate return would bear to the total amount of the taxes for all members of the group so computed.

(3) The tax liability of the group (excluding the tax increases arising from the consolidation) shall be allocated on the basis of the contribution of each member of the group to the consolidated taxable income of the group. Any tax increases arising from the consolidation shall be distributed to the several members in direct proportion to the reduction in tax liability resulting to such members from the filing of the consolidated return as measured by the difference between their tax liabilities determined on a separate return basis and their tax liabilities based on their contributions to the consolidated taxable income.

* * *